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IN THE SUPREME COURT OF
THE UNITED STATES

October Term, 1980

DOUGLAS E. FRANK and MICHAEL H. FOLB,

Petitioners,

v.

UNITED STATES TRUST COMPANY OF NEW YORK, and LAVENTHOL, KREKSTEIN, HORWATH and HORWATH,

Respondents.

PETITIONERS' REPLY BRIEF IN SUPPORT OF THEIR PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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THIS CASE RAISES AN ISSUE MERITING SUPREME COURT REVIEW.

Respondents seek to dissuade Supreme Court consideration of this case by attempting to trivialize the critical issue here presented. We believe this effort is unconvincing and that the Court ought to grant certiorari to address this question. The precise questions presented by this case are described in some detail in the Petition for Writ of Certiorari. This Reply will restrict itself to explaining the major reason why this case is especially appropriate for consideration by the Supreme Court.

No one need belabor the observation that the federal judiciary is struggling to administer an incredibly heavy caseload. A significant portion of that caseload involves federal securities cases. Moreover, the amount of judicial

resources consumed by these cases is disproporticnate to the number of cases, for securities litigation tends to be among the most complex and "big" of federal litigation. In addition, these cases very often, if not usually, involve multiple defendants claimed to be responsible for the alleged injury to the plaintiff.

The clear message sounded by the Ninth Circuit in this case is that, except in the most limited circumstances, a party gains virtually nothing through partial settlement of a securities law class action. Furthermore, we believe the Ninth Circuit's decision leaves the issue of settlement shrouded in an unnecessary and unfortunate uncertainty.

In view of the substantial impact of multi-party securities litigation, we believe that the interests of efficient federal case management could be significantly advanced by examining an opinion

that now effectively bars partial settlements of class actions. We believe that resolution of this matter would also serve important principles of federalism that have been unnecessarily sacrificed by the Ninth Circuit opinion.

In this case, several defendants in a securities law class action entered into a settlement agreement with plaintiffs. The settlement was conditioned upon approval by the district court and was so approved even though one of the non-settling defendants attacked the settlement as "unfair."

Notwithstanding the settlement, the Ninth Circuit, in reversing the federal district court, has said that the non-settling defendants may maintain contribution claims against the settling defendants. The effect of this ruling is, quite simply, to vitiate the incentive for such settlements and hence to prolong and

broaden the securities cases on the federal dockets. We strongly submit that this decision serves no legitimate legal purpose, but serves only to frustrate sound legal and administrative principles.

Respondents (as well as the Ninth Circuit) justify permitting contribution by the fact that the Securities Act of 1933 contains a provision authorizing contribution, whereas the statute makes no specific mention of encouraging settlements. We submit, however, that this observation is but the beginning of analysis, not the end of it.

It is certainly true that § 77k(v) describes the liability of securities defendants as "joint and several", and further provides that contribution is available "as in cases of contract." This provision, of course, clarifies that the common law tort prohibition against any contribution among joint tort-feasors will

play no role in securities litigations. But it certainly does not resolve the issue of what effect to accord to a settlement between plaintiffs and less than all defendants. That contribution is "available" (unlike the situation in the case of common law torts) does not excuse us from applying traditional legal analysis to resolve the issues presented by the appeal.

Under the Ninth Circuit decision, virtually no effect is accorded to the partial settlement. This result, we believe, cannot be justified under recognized legal principles and appropriate statutory policy. It is a state of affairs which ought not to be perpetuated.

In the Petition for Writ of Certiorari, we demonstrated that barring contribution would fully promote all identifiable policies, whereas permitting it served none.

We showed, for example, that applicable State law would favor denial of contribution in the case of a good faith partial settlement (Petition, page 13). Similarly, "federal common law" holds that a good faith settlement bars contribution (Petition, page 19).

In view of this unanimity of view, it was next necessary to inquire whether there is something distinctive about securities actions which requires a contrary result.* There is not.

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* In the Petition, we quoted from the case of Stratton Group Limited v. Sprayregen, 466 F.Supp. 1180, 1189, n. 11 (S.D.N.Y. 1979 (Petition, pages 12-13) which suggested the following functional analysis: In resolving the apparent conflict between contribution and the encouragement of settlements, the appropriate analysis is to determine the policy of the appropriate state concerning contribution, and then to determine whether a contribution action against the settling defendant is consistent with that policy, while at the same time assuring that the federal securities law policy of deterrence is adequately served. Respondents make no challenge to the sense or substance of that approach, but simply dismiss Stratton as dictum.

The Ninth Circuit has suggested that permitting contribution reinforces the deterrent effect of the securities law by preventing parties from "escaping loss." The Ninth Circuit also suggested that contribution gives the injured investor an extra measure of protection by broadening his potential sources of reimbursement. (637 F.2d at 675.) Neither reason can withstand analysis.

Defendants who enter into a good faith settlement with plaintiffs are not "escaping loss." Rather, they have had to make their peace with an arms-length plaintiff. If the settling defendants had not agreed to a price deemed appropriate by the plaintiff-investors, there would have been no settlement.* Moreover, far

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* Here, the plaintiffs carefully examined the financial condition of the settling defendants prior to consummating the settlement. Appendix A to Petition, page 11.

from affording the injured investor "an extra measure of protection by broadening its potential source of reimbursement for damages," the Ninth Circuit actually works to the disadvantage of plaintiff-investors. Surely, the position of a plaintiff-investor is advanced if he is permitted to reach accommodations which maximize the extent (and likelihood) of his ultimate recovery. Under the Ninth Circuit decision, however, plaintiffs will be unable to do this because the incentive for defendants to settle has been eliminated.

Having shown that all considerations militate strongly against permitting contribution in the case of a good faith settlement, we must once again ask why it was denied in this case. A careful reading of the Ninth Circuit opinion suggests that the overriding consideration is the fact that § 77k(v) contains the language

that contribution is available "as in cases of contract." This brings us directly to the conflict between the Ninth Circuit and Second Circuit in their analysis of the impact of settlement on contribution. The Second Circuit decision in Herzfeld v. Laventhol, Krekstein, Horwath and Horwath, 540 F.2d 27 (2d Cir. 1976) directly contravenes the rationale of the Ninth Circuit in this case.

In Herzfeld, plaintiff brought securities law claims against Laventhol and various other parties. The defendants other than Laventhol settled with plaintiff for $357,000. Laventhol then brought a third-party action for indemnity and contribution against the settling defendants. At trial, the district court found Laventhol liable for an additional $153,000. The court also found that Laventhol was entitled to pro rata contribution from the defendant Allen & Company in the amount of one-half of $153,000.

On appeal, the Second Circuit ruled that the settlement barred the claim for contribution. The court found that, by its settlement, the settling party "removed itself from the category of a tort-feasor defendant." Id. at 38. The court thus concluded that by virtue of the settlement, Allen & Company could not be a defendant in an action by plaintiff - and thus could not be considered a "joint feasor" vis-a-vis plaintiff in the suit. Id. at 39. Since contribution unquestionably requires that the party against whom contribution is sought be a "joint-feasor" with the party seeking contribution,* the court overturned the contribution award.

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* It is recognized that contribution under the securities law, like contribution under common law, requires that the party against whom contribution is sought be a joint wrongdoer vis-a-vis the claims alleged by plaintiff. See, e.g., Index Fund, Inc. v. Hagopian, 471 F.Supp. 738, 746, n. 6

[footnote continued on next page]

Respondents assert that Herzfeld is not applicable to our facts because petitioners have not paid enough in their settlement with plaintiffs. In so arguing, respondents simply choose to ignore the Second Court's legal theory that contribution is not available as to defendants who, by virtue of the settlement, can no longer be considered a wrongdoer as to the plaintiff. This decision of Herzfeld was reached notwithstanding that

[Continuation of footnote]

* (S.D.N.Y. 1976) ("although contribution in Rule 10b-5 securities cases, as well as common law fraud cases has been authorized, that right has so far been limited to recovery among joint tort-feasors."); Wassel v. Eglowsky, 399 F.Supp. 1330, 1367 (D.Md. 1975), aff'd 542 F.2d 1235 (4th Cir. 1976) ("The necessary predicate for a contribution recovery is that the party it is recovered from be a 'joint tort-feasor', i.e., that he be 'liable in tort to the same person for the same harm'" (citing Restatement 2d of Torts, § 886A).); Herzfeld v. Laventhol, Krekstein, Horwath and Horwath, 540 F.2d 27, 38-9 (2nd Cir. 1976).

the securities statute therein involved provided for contribution.* Instead of following the legal ratio decidendi of Herzfeld, the Ninth Circuit has embarked upon a vague "numbers game" in resolving contribution claims. Just how much, it must be asked, must a defendant pay before he no longer is to be considered a tort-feasor vis-a-vis the plaintiff? What is the "fair share" to which the Ninth Circuit refers? For example, would respondent Frank in this case have to pay one-half (i.e., one-half each for Frank and

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* As noted above, Section 78k(v) clarifies that the common law bar against contribution of joint tort-feasors is inapplicable to securities cases. The provision does not speak to the issue of settlement by one of the alleged tort-feasors, and the Herzfeld case clearly holds that a contribution provision does not have the absolute application accorded to it by respondents and the Ninth Circuit.

U.S. Trust) of the amount claimed by plaintiff before he loses the status of joint feasor? Or, would one-third of the total be enough since Folb is also a cross-defendant and contribution is usually awarded on a pro rata basis in securities cases?* Perhaps it should be one-fourth of the total since Laventhol might also share in this liability; or, in view of the cross-claims against Corwin, Pizer, Siders, Horwitch and Myers, maybe

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* "'The only workable rule to apply ... is the one of pro rata contribution. ... On the whole, judged by administrative expediency, this is probably as simple and as satisfactory a way to handle the matter as any. To resort to fault, compensation, or extent of participation would be even more confusing.'" 3 L. Loss, Securities Regulation, at 1738, quoting with approval Douglas & Bates, "The Federal Securities Act of 1933," 43 Yale L.J. 171, 178-181 (1933).

it should be one-ninth of the alleged damage.* What would the number be if "control persons" of Laventhol and U.S. Trust were brought into the action?

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* We note that the Ninth Circuit's treatment of the case of the additional directors evidences internal inconsistency on the issue of contribution. The above-named directors had obtained a summary judgment against plaintiffs. The Ninth Circuit thus affirmed the dismissal of the cross-claim against them because "no longer can it be said that these appellees may become liable to make the same payment as that for which appellants may be found liable," 637 F.2d at 676. But in light of the settlement between plaintiffs and petitioners, the very same thing should be said of petitioners. And if, as suggested by respondents and the Ninth Circuit, § 77k(v) affords a right to a defendant that cannot be vitiated by the acts of plaintiffs, should not the non-settling defendants be afforded the right to establish the liability of such parties for contribution purposes? That would be part of their contribution claim in any event. What justification is there to accept the plaintiff's conduct in opposing the motion for summary judgment but ignoring such conduct in settling the action?

Indeed, if one looks at the facts of the Herzfeld case, the same type of numerical uncertainty would have been involved if the Second Circuit had accepted the position espoused by respondents. Laventhol was but one of the twelve defendants sued by Herzfeld, 540 F.2d at 28. Laventhol, however, would up paying approximately 30% of the damages ($153,000 of $510,000) rather than a pro rata amount of 8-1/3% (1/12). True, Allen & Company paid more than half of the amount due to plaintiff ($357,000 of $510,000), but this payment was made on behalf of all of the other defendants, Id. at 27. Thus it is clear that the settling group in total paid less than its pro rata share, and Laventhol wound up paying more. But surely this is a chance that a party takes in choosing not to settle. If Laventhol had prevailed on the merits, it would have

wound up paying nothing at all to plaintiff, whereas plaintiff would have kept the consideration received from the settling defendants. Similarly, if respondents prevail in the main action against plaintiffs, they pay nothing; but the consideration paid by petitioners to plaintiff (as in any settlement) is never returned. Surely nothing would more severely undermine the strong federal policy in favor of settlement of securities law cases then to shroud the effect of settlement in this fog of numerical uncertainty. (i.e., What percentage of a claim must a defendant pay to buy his final peace in a securities law litigation?)

Moreover, where, as here, and in many other cases, a substantial portion of the consideration flowing to plaintiff is non-cash in nature, must the courts engage in thorny valuation problems to gauge the worth of the settlement? As previously

shown, petitioners agreed in the settlement to assist in the development of facts relating to plaintiff's case, including the searching for and identification of voluminous records, both in and out of the custody of plaintiff, and the spending of substantial time of petitioners and their counsel on exploration of various aspects of the case. What dollar value is to be put on this?

Plain logic as well as law dictates that either a good faith settlement eliminates one's status as a potential joint tort-feasor for purposes of contribution (without regard to the precise amount paid) or it does not . We believe that logic, policy and the above-described law should lead this Court to conclude that a settlement <u>does eliminate</u> a defendant's status as a joint tort-feasor and that it should bar the claims for contribution asserted in this case.

In summary, we believe that the Ninth Circuit decision, if permitted to stand, will effectively deter partial settlements of securities law actions.*

We believe that the decision of the Ninth Circuit is unsound and that it is important for the Supreme Court to examine this important issue at the present time.

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* Respondent U.S. Trust suggests that this Court ought to wait until there are more circuit opinions on the issue before addressing the problem. This is not a realistic suggestion. Given the Ninth Circuit decision, there will be few, if any, securities law defendants willing to partially settle a securities case. Hence, we believe that now, not later, is the appropriate time to address this matter.

RESPECTFULLY SUBMITTED this 2 day of June, 1981.

DUSHOFF & SACKS

By _____
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and

By _____
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CERTIFICATE OF SERVICE

I, Allan J. Kasen, one of the attorneys for Douglas E. Frank and Michael H. Folb, petitioners herein, and a member of the Bar of the Supreme Court of the United States, hereby certify that on the 2 day of June, 1981, I deposited in a United States mailbox located at 111 W. Monroe, Phoenix, Arizona, with first-class postage prepaid, and properly addressed to the Clerk of the Supreme Court of the United States, within the time allowed for filing, an original and 40 copies of the foregoing "Petitioners' Reply Brief in Support of Their Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit", and I further certify that three copies of the said document were similarly mailed on said date to each of the following counsel:

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